Military Lending Act Rule (32 C.F.R. pt. 232)

Recommended Clarifications and Modifications
April 2016

The American Bankers Association, the American Financial Service Association, the Association of Military Banks of America, the Consumer Bankers Association, the Credit Union National Association, the Independent Community Bankers of America, the National Association of Federal Credit Unions, and the Financial Services Roundtable submit the following suggested clarifications and modifications to the Military Lending Act regulation for which compliance is mandatory on October 3, 2016. We urge the Department of Defense to adopt on an interim basis and propose for public comment "final interim" amendments to the regulation to promote transparency and consistency for covered borrowers, consumers, regulators, courts, and the lending industry. Providing guidance on the issues discussed below will help ensure that military personnel and their spouses and dependents continue to have access to a wide range of credit products. Please contact Nessa Feddis (nfeddis@aba.com, 202 663 5433) or Steven Lepper (Steven.Lepper@AMBAHQ.org, 540-347-3305) for further information.

I. Use of a Check or Other "Method of Access" to Make Payments

- **Issue:** Section 232.8(e) provides that it is unlawful if a creditor "uses a check or other method of access to a deposit, savings, or other account maintained by the covered borrower," subject to certain exceptions. The regulation thus appears to prevent creditors from accessing accounts by accepting payments from covered borrowers by check or via an electronic fund transfer (as defined in Regulation E, 12 C.F.R. pt. 1005), including, for example, via ACH debits. We do not believe this result was intended because it will be harmful to covered borrowers, particularly those deployed overseas, who will not be able to use all available payment options.

- **Proposed Solution:** Amend § 232.8(e) by adding a new paragraph (4) to state:

  (4) This paragraph (e) does not prohibit a covered borrower from making a payment or a creditor from accepting a payment by use of a check or other method of access to a deposit, savings, or other account maintained by a covered borrower for an extension of consumer credit after the consumer has become obligated on a transaction or an account has been opened.

II. Taking a Security Interest in Funds

- **Issue:** Section 232.8(e)(3) provides that, if not otherwise prohibited by applicable law, a creditor may take a security interest in funds "deposited *after* the extension of credit" in an account. This provision will prevent covered borrowers from receiving secured credit cards and other loans secured by funds placed in a deposit account, such as a savings account or CD, *before* or *at the time o*f an extension of credit, which can be an important source of credit for some consumers, including covered borrowers and can enable them to establish or improve their credit history.

- **Proposed Solution:** Amend § 232.8(e)(3) to state:

  (3) If not otherwise prohibited by applicable law, take a security interest in funds deposited~~ after the extension of credit~~ in an account established or maintained in connection with the consumer credit transaction.

III. Inclusion of Conditional Terms and Disclosures in Agreements

- **Issue:** The broad language in § 232.9(c) regarding contract voidance raises the risk that creditors will no longer be able to use a single agreement for all borrowers that includes disclosures in the agreement. To reduce operational burden and risk and ensure covered borrowers receive the correct contract terms, many creditors would prefer to use a single credit agreement for all borrowers that includes:

  - Provisions prohibited by part 232 (including arbitration) but affirmatively states that those provisions do not apply to covered borrowers;

  - The MAPR statement, consistent with § 232.6(c)(2); and

  - The Regulation Z disclosures, consistent with longstanding practice for certain products.

  However, creditors are concerned that inclusion of a prohibited provision (even with an affirmative statement that it does not apply to covered borrowers) or an inadvertently erroneous disclosure will result in a court deeming a contract void under § 232.9(c).

- **Proposed Solution:** Amend § 232.9(c) to state:

  (c) *Contract void.* Any credit agreement, promissory note, or other contract with a covered borrower that fails to comply with 10 U.S.C. 987 as implemented by this part or which contains one or more provisions prohibited under 10 U.S.C. 987 as implemented by this part is void from the inception of the contract. However, a credit agreement, promissory note, or other contract is not void solely because it includes:

    (i) An otherwise prohibited provision that expressly excludes covered borrowers; or

(ii) A disclosure required by § 232.6 that fails to conform with the applicable timing, content, or format requirements. This provision does not affect any other applicable remedies under this part.

IV. Timing of Written Disclosures

- **Issue:** Section 232.6(a) and (d) states that a creditor must provide the required disclosures to a covered borrower in writing in a form the borrower may keep "before or at the time" a consumer becomes obligated on a transaction or establishes an account. While longstanding provisions of Regulation Z permit delayed provision of disclosures for telephone and similar purchases, the timing requirement in § 232.6(a) and (d) would prevent covered borrowers from obtaining credit for emergencies or other purposes by telephone. We believe covered borrowers would benefit from being able to make telephone and similar purchases and receiving all of the MLA disclosures consistent with the Regulation Z timing requirements for those purchases.

- **Proposed Solution:** Amend § 232.6 by adding a clause in paragraph (a) and adding a new paragraph (a)(4) to state:

  (a) *Required information*. With respect to any extension of consumer credit (including any consumer credit originated or extended through the internet) to a covered borrower, except as provided in paragraph (a)(4) of this section, a creditor shall provide the covered borrower the following information before or at the time the borrower becomes obligated on the transaction or establishes an account for the consumer credit:

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  (4) Notwithstanding the requirements of this paragraph, a creditor may provide the information in paragraphs (a)(1) through (3) for mail, telephone, or facsimile machine purchases in accordance with the timing provisions of Regulation Z, 12 C.F.R. §§ 1026.5(b) and 1026.17(g) for open-end accounts and closed-end transactions, respectively.

V. Oral Disclosures

- **Issue:** Section 232.6(a)(3) and (d)(2) require creditors to provide orally a description of the payment obligations of the borrower before or at the time the borrower becomes obligated on a transaction or establishes an account. Alternatively, a creditor may provide certain Regulation Z disclosures, which could require a highly complex, individualized oral disclosure that will likely be confusing and unhelpful to covered borrowers who receive more specific disclosures in writing. In addition, individualized oral disclosures will not be operationally feasible or practical for creditors and will likely cause them to consider discontinuing certain products.

- **Proposed Solution:** Permit creditors to comply by providing a model statement orally, similar to the model statement for the MAPR in § 232.6(c)(3) and consistent with the intent of § 987(c)(1)(C) of the statute that covered borrowers understand their payment obligations. Amend § 232.6(c) to add a new paragraph (4):

  (4) *Model statement.* A statement substantially similar to the following statement may be used for the purpose of paragraph (a)(3) and (d)(2) of this section: "Federal law requires that you receive a clear description of your required payments. Please review the disclosures and your credit agreement carefully to understand your payment obligations."

VI. Timing of Database Inquiry

- **Issue:** Section 232.5(b)(3) provides that a creditor may only obtain the safe harbor for the covered borrower determination if it makes the determination described in § 232.5(b) and keeps the record of the information obtained "solely at the time" (1) a consumer initiates the transaction or 30 days prior to that time, (2) a consumer applies to establish the account or 30 days prior to that time, or (3) the creditor develops a "firm offer of credit." Under this provision, a creditor would not be able to obtain the safe harbor if it determines whether an applicant is a covered borrower after a consumer applies for a loan. However, for operational and other reasons, creditors may not be able to make this determination until after a consumer applies for an account. Lenders should be able to make the determination at any time prior to account opening.

- **Proposed solution:** Amend the last sentence of § 232.5(b)(3) and subparagraphs (b)(3)(i) and (ii) to read:

  (3) *Determination and recordkeeping; one-time determination permitted*. . . . A creditor may make the determination described in this paragraph (b), and keep the record of that information obtained at that time, solely at the time—

  (i) A consumer becomes obligated on ~~initiates the~~ a transaction or during the 30–day~~s~~ period prior to that time;
  (ii) A consumer ~~applies to~~ establishes ~~the~~ an account or during the 30–day~~s~~ period prior to that time; or
  (iii) The creditor develops or processes, with respect to a consumer, a firm offer of credit that (among the criteria used by the creditor for the offer) includes the status of the consumer as a covered borrower….

VII. Safe Harbor for Assignees

- **Issue:** Section 232.3(i) provides that, as used in part 232, a "creditor" includes an assignee, subject to certain exceptions. However, § 232.5(b)(2)(i)(B) states that "a creditor *(including an assignee)*" may not engage in an historic lookback of the DOD database to determine if a consumer had been a covered borrower. While this discrepancy was likely unintentional, it could be read by a court to mean that, for purposes of § 232.5, "creditor" does not include an assignee unless specifically stated and therefore an assignee may not rely on the creditor's covered borrower determination. This could have a significant impact on the ability of creditors to sell loans because of the uncertainty of whether an assignee can rely on the safe harbor provided to creditors.

- **Proposed Solution:** Amend § 232.5(b)(2)(i)(B) by deleting the phrase "(including an assignee)" after the word "creditor."

VIII. Exemption for Credit Secured by Real Estate With No Dwelling

- **Issue:** Section 232.3(f)(2)(i) and (iii) excludes from coverage residential mortgages secured by a "dwelling, including a transaction to finance the purchase or initial construction of the dwelling." However, loans secured by real property that do not contain a dwelling are not excluded. For example, consumers sometimes purchase vacant land for vacation or retirement purposes without at the same time obtaining a loan to construct a dwelling. We believe that this is an unintended oversight, but it could restrict covered borrowers' access to such loans.

- **Proposed solution:** Amend § 232.3(f)(2) by replacing existing paragraph (i) with:

  (i) A residential mortgage, which is any credit transaction secured by an interest in real property or a dwelling, including a transaction to finance the purchase of real property, a transaction to finance the purchase or initial construction of a dwelling, any refinance transaction, any home equity loan or line of credit, or any reverse mortgage;

IX. MAPR Calculation – Zero Balance Billing Cycles

- **Issue:** Section 232.4(c)(2)(ii)(B) provides that if there is "no balance" in a billing cycle, a creditor may not impose "any fee or charge" during that cycle, except for a participation fee on open-end credit plans so long as it does not exceed $100 per year, except that the $100 per year limit does not apply to bona-fide credit card participation fees. This provision creates several problems.

  First, this provision prohibits a creditor from imposing an application fee for an open-end (non-credit card) plan, including overdraft lines of credit and personal lines of credit, if there is no balance in the billing cycle when the application fee is imposed. Consumers frequently establish open-end (non-credit card) plans without immediately taking an advance. In this case, a creditor would be prohibited from assessing an application fee. This could lead creditors to impose (annual) membership fees rather than one-time application fees, which may be harmful to consumers, including covered borrowers. Thus, we believe the provision should be revised to treat application fees in as participation fees are treated.

Second, as worded, this provision inadvertently fails to give full effect to the bona fide fee exclusion and could be read to prohibit all open-end accounts, including credit card accounts, from imposing, for example, a minimum interest charge, cash advance fee, foreign transaction fee, late payment/NSF fees, or other fee, even if the fee was bona fide and reasonable (for credit cards) or otherwise not included in the MAPR calculation (such as a late fee) anytime there is "no balance" in an account. "No balance" appears to mean that the average daily balance for the cycle is zero or negative. A zero (or negative) balance could arise in several circumstances, for example, if a consumer makes a payment substantially larger than the outstanding balance. In addition, a zero balance could occur if a consumer returns merchandise the month after it was purchased (and paid for) and gets a "credit" for the amount of the transaction in a subsequent cycle. Similarly, a consumer could dispute a paid transaction and receive a credit in a later cycle if the creditor determines there was a billing error. In these and other circumstance, the average balance in an account could be zero, even though the consumer makes a purchase or takes a cash advance in the same cycle in which a fee is charged. Modifying the rule to apply only if there is no balance for every day in the billing cycle would avoid these anomalies

Third, limiting the "safe harbor" for charging a participation (or application) fee only when a balance is "zero" has the effect of prohibiting such fees if a covered borrower has a low balance in the billing cycle in which that fee is charged. This is because assessing such a fee when there is a low balance would cause the MAPR to exceed 36%. This creates the anomaly of permitting a participation fee if there is no balance in the billing cycle, but prohibiting such a fee if there is a "small" balance in the cycle. The result seems contrary to the intent to permit reasonable participation fees when there is no balance in the cycle in which the fee is charged.

- **Proposed Solution:** Section 232.4(c)(1)(iv) should be modified by adding "(A)" after the heading, and by adding a semicolon and the word "and" at the end of that subparagraph.

    - A new subparagraph (B) should be added to section 232.4(c)(1)(iv) to read:

      (B) Notwithstanding the requirements of this section 232.4(c), a creditor is not required to include in the MAPR an application fee or a fee for participation in any plan or arrangement for an open-end credit provided that fee does not exceed $100 per annum, regardless of the billing cycle in which the fee is charged; however, this $100 limitation does not apply to credit card plans.

    - Section 232.4(c)(2)(ii)(B) should be modified to read:

(B) *No balance or negative balance during a billing cycle.* For open-end credit, if ~~the MAPR cannot be calculated in a billing cycle because~~ there is no balance or a negative balance for every day in ~~a~~ the billing cycle, a creditor may not impose any fee or charge during that billing cycle that must be included in the MAPR, except that the creditor may impose an application fee or a fee for participation in any plan or arrangement for that open-end credit so long as the application or participation fee does not exceed $100-per annum, regardless of the billing cycle in which the application or participation fee is imposed; *provided, however,* that the $100-per annum limitation on the amount of an application or participation fee does not apply to a bona fide application or participation fee imposed in accordance with paragraph (d) of this section.